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C O N F I D E N T I A L ULAANBAATAR 000020

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SUBJECT: MONGOLIA ON A RISING CHINA: HEDGING PREFERRED BUT  
ENGAGEMENT REQUIRED (C-AL8-02576)

REF: A. 08 STATE 134378

[1](#)B. 09 ULAANBAATAR 014

Classified By: Political Counselor Andrew Covington, Reasons 1.4 (b) and (d)

[1](#)1. (C) Summary: Mongolia faces the challenge of being a large, sparsely populated, landlocked country sandwiched between China and Russia. Mongolia's Third Neighbor Policy of building economic, political, social and military relations with outside countries ) the United States foremost among them ) speaks directly to Mongolian concerns about the influence of its neighbors. These concerns shape the discussions taking place both in Parliament and in Ulaanbaatar's cafes, but the words are chosen carefully so as not to sour relations with China and Russia. The answers below, in response to Reftel A, focus on the China side of this balancing act. In the face of an overwhelmingly large, speedily developing and undemocratic neighbor to the south, most Mongolians understand that a certain amount of economic engagement is unavoidable and in fact desirable, but wish to limit Chinese influence in their affairs to the extent possible. End Summary.

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Background: China within the Mongolian World View  
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[1](#)2. (SBU) Geography and history are the two compelling factors that determine Mongolia's foreign policy. Mongolia is a landlocked country in northeast Asia with only two neighbors: densely populated China to the south and sparsely populated Russia to the north. Known best for its worldwide dominance under Genghis Khan in the 13th Century, Mongolia was later mostly integrated into the Chinese Qing Dynasty for 200 years until declaring independence and falling under Soviet influence in the early 20th Century. In 1991, the pro-democracy movement established the Mongolia of today, characterized by regular and generally free and fair elections.

[1](#)3. (C) These factors have led Mongolia to adopt its Third Neighbor Policy of reaching out to friendly Western nations, among whom the U.S. is most critical, although Europe, Japan, Korea and others also play significant roles. The government of Mongolia pays keen attention to the intentions of its neighbors, especially China. Despite 70 years of Soviet domination, with purges that killed tens of thousands among the monks and educated elite, the majority of Mongolians today consider China a greater threat than Russia to its national identity and sovereignty. This may be a legacy of the many Russian-educated politicians still at the pinnacles of power. Nonetheless, Mongolians would prefer to see Russia and China maintain good relations so that neither is again tempted to pull Mongolia into its sphere as a buffer against the other.

[1](#)4. (C) The concern in the 21st Century stems more from a fear

of being swamped by a flood of Chinese immigrants who would stamp Mongolia out of existence. The Mongolians have only to look at China,s province of Inner Mongolia, where four million once-dominant ethnic Mongols now find themselves surrounded by twenty million Han Chinese, to see how such a scenario might play out. Moreover, the Chinese handling of Tibet and the Dalai Lama goes over poorly in Mongolia, where Tibetan Buddhism is enjoying a post-Soviet resurgence and the Dalai Lama is revered. (Note: "Dalai" is a Mongolian word meaning ocean and came to be part of the Tibetan leader,s title through a Mongolian khan.)

15. (C) Nonetheless, the government of Mongolia has tried quietly to maintain as pragmatic an approach toward China as possible, despite strong public opinion to keep its distance. Mongolia knows that China is the primary market for its extensive coal, copper, gold, and other mineral deposits, as well as its livestock resources. China must and will remain the top market for Mongolia as it transforms its economy to a greater value-added orientation, which is the stated intent of Mongolia,s leaders. Russia,s sparsely populated east is not a viable market, Mongolia has no sea port, and transportation costs to other markets in Europe and the U.S., and even to Japan and Korea, are high.

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Answers to Reftel A Questions  
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16. (C) QUESTION A: ENGAGEMENT VERSUS HEDGING. As can be seen from the above background, Mongolia,s relevant foreign policy is the Third Neighbor Policy, a hedge against a rising China. Without question, the Mongolians are also engaged with the Chinese, but the preference is to keep them at arm,s length where possible.

17. (C) An example of this orientation are the negotiations currently taking place to develop China,s massive Tavan Tolgoi coking coal deposit located near the Mongolian-Chinese border. Chinese state-owned firm Shenhua has expressed an interest in leading development of the project, but the Mongolians tell us privately they would prefer to offer the Chinese a secondary role in development, with a Western firm (possibly the U.S. firm Peabody Energy) taking the lead. Mongolia understands that China will be the main market for the coal and so must have a role in the mining process. However, the GOM wants to keep the primary customer for the product from controlling the mine operation in the belief that Chinese state-owned firms will not maximize the value of the coal in Mongolia.

18. (C) In ten years this situation is unlikely to change significantly. At best, Mongolia may be able tip the leverage equation with China to be slightly less unfavorable if it can put into play the foreign investment needed to exploit Tavan Tolgoi and other coal and mineral deposits and thereby boost its GDP by double-digit figures. In the case of Tavan Tolgoi, Peabody has risen to a leading position among the firms competing for the project specifically because it is American. The Mongolian government and public believe that an American player will bring best practices, financing, and U.S. government political support that might be brought to bear on the Chinese should the Chinese balk at Mongolian coal exports into, or transshipped through, China.

19. (C) QUESTION B: PROMINENCE OF CHINA ON THE AGENDA. Mongolia affords the management of its relationship with China high priority, approximately equal to maintaining good relations with Russia and seeking other outlets through its Third Neighbor Policy. However, domestic concerns such as growth and development, health care, education, and electoral reform usually rank higher in priority.

110. (C) QUESTION C: INTEREST GROUPS AND PUBLIC OPINION. The military knows it could not hope to repulse a Chinese invasion, and as such has shifted gears in recent years to focus more on peacekeeping activities abroad and maintaining good relations with the U.S. military and others through

annual exercises such as Khan Quest. The Mongolians also cooperated in an equipment maintenance exercise with the Russians in November 2008 that brought in the largest number of Russian troops to be present since the Soviet withdrawal.

¶11. (SBU) A number of nationalist and ultra-nationalist groups have formed in recent years as part of a backlash against foreigners in Mongolia, and the Chinese receive the sometimes violent brunt of their nationalist anger.

¶12. (C) NGOs are increasingly sophisticated and influential in Mongolia, although many are still in the infancy stage in learning the game of influence. Some local NGOs with social development portfolios tend to view China as a source of illicit drugs (though very minor), illegal economic migration, and as a destination for human trafficking victims. However, a smaller number are seeking to partner with the nascent NGOs in China to combat these and other problems.

¶13. (C) Suspicious of China, Mongolians strive toward self-sufficiency in as many areas as possible, and the government largely adheres to this orientation. In January 2009, after reports surfaced in the media that the GOM was considering a \$3 billion loan package from China to mediate the impact of the world financial crisis, man-on-the-street media reports (including blogs) blasted the idea, crying that the government was selling their children's future to the Chinese. The government may now scale back or eliminate the option. (Note: Mongolia may accept an assistance package from the IMF to overcome its 2009 revenue crunch due in large part to falling commodity prices. See Reftel B. Separately, in 2006 Mongolia negotiated a USD 300 million concessional loan with China, broken down into USD 60 million in cash and USD 240 million in industrial credits that must be used with China. However, Mongolia has used only a small fraction of this available money and credit.)

¶14. (C) QUESTION D: CHINA'S INFLUENCE ON MONGOLIAN POLICIES. China's greatest influence over Mongolia is in trade relations -- it absorbs some 70 percent of Mongolian exports, most of which are raw or unfinished products that either feed China's energy needs or receive added value in China's factories. This percentage has risen with the development of Mongolia's mineral sector. Chinese firms and individual investors dominate foreign direct investment (FDI) into Mongolia, especially in the minerals sector and some construction. Over two-thirds of the last decade's FDI, or about USD 2.5 billion, has come from China. By comparison, U.S. firms have invested about USD 200 million over the same period. Mongolia has obtained a limited quantity of military aid from China, in the form of buses, trucks, building supplies, shotguns and riot control ammunition. The Russians are much more involved with Mongolia's military, due to the preponderance of Soviet-era equipment in the Mongolian arsenal. The Chinese occasionally offer diplomatic support to the Mongolians when their interests coincide, but the Mongolians have generally been more receptive to our demarches on issues before the UN General Assembly. Moreover, the Chinese treatment of the Dalai Lama often puts the Mongolians at odds with the PRC.

¶15. (C) QUESTION E: BENEFITS FROM CHINA. The Mongolians do not anticipate significant diplomatic, security or domestic political benefits from China for reasons outlined above. Economic benefits will be in the form of a hungry market for Mongolia's developing mining sector, as outlined in paras 7 and 8. See para 13 for a description of the resistance generated by China's offer of a \$3 billion loan package to help Mongolia with its 2009 revenue shortfall.

¶16. (C) QUESTION F: GROWTH OF CHINA'S POWER. Mongolia expects China's power to grow relative to its own and relative to other countries of the region. Mongolia also expects China's power to grow relative to the United States for the foreseeable future, but the Mongolians expect the U.S. to remain the sole superpower for decades to come.

¶17. (C) QUESTION G: CHINA,S DISPOSITION TOWARD THE REGION AND THE U.S. Most Mongolians believe that the U.S. and China will continue on their current path of generally cooperative relations punctuated by occasional friction. Many Mongolians in government and the public view China as seeking to displace a degree of U.S. influence in East Asia, but there is disagreement as to whether China seeks preeminence or simply a freer hand. Chinese preeminence in the region is not something democratic, landlocked Mongolians would wish to see. They see PRC preeminence as a threat to their democracy, independence, and trade options.

¶18. (C) Mongolians view U.S.-Chinese cooperation on the Six Party Talks (6PT) as the paramount example of how the two can work together for the benefit of the region. Mongolian policy makers continue to express their interest in having Mongolia host further meetings related to or in parallel with 6PT negotiations.

¶19. (C) QUESTION H: HEDGING AS A SAFEGUARD. Most Mongolians view hedging as an essential safeguard against Chinese superiority. This is precisely the intent of the Third Neighbor Policy as described in para 3. Such hedging is the reason a \$3 billion loan package from China is booed in the press and why Chinese companies seeking majority involvement in Mongolian mining projects are fighting an uphill battle.

¶20. (C) QUESTION I: U.S. STRATEGIC ENGAGEMENT. The GOM views continued U.S. strategic engagement in Mongolia as both essential and eminently desirable. Mongolia understands that U.S. interests in the country itself are limited, but Mongolia also knows its best option for maintaining its freedom of economic and political movement is to partner with influential countries beyond its neighbors. The United States is foremost among those countries that have been approached in this fashion as Third Neighbors.

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